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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45
	)	
Forward-Looking Mechanism For High Cost Support for Non-Rural LECs	)	CC Docket No. 97-160

COMMENTS
OF
ALIANT COMMUNICATIONS CO.

Aliant Communications Company ("Aliant"), by its attorneys, hereby submits its comments in the above-captioned[1] as requested by the Commission in its June 4, 1998 Public Notice.[2] These comments address whether the cost study submitted by the Nebraska Public Service Commission ("NPSC") to determine federal universal high cost support for the state of Nebraska complies with the criteria established in the *Universal Service Order*.[3] These comments also address Ameritech Michigan's request for waiver of the Commission's authorized ranges of economic lives and future net salvage percentages used to calculate depreciation expenses.[4]

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1 *See Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 12 FCC Rcd 8776 (1997) ("*Universal Service Order*") and *Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket No. 97-160, 12 FCC Rcd 18514 (1997).

2 *See FCC Public Notice*, DA 98-1055, released June 4, 1998.

3 *See State Forward-Looking Cost Studies for Federal Universal Service Support*, CC Docket Nos. 96-45, 97-160, DA 98-217 (rel. Feb. 27, 1998) ("*State Forward-Looking Cost Studies Order*").

4 *See Ameritech Michigan Request for Waiver*, CC Docket Nos. 96-45, 97-160, filed May 26, 1998.

I. Criteria for State Cost Studies

Aliant believes that the cost study submitted by the NPSC generally meets the criteria established in the *Universal Service Order* with the exception of Criterion 3. While the rate of return adopted by the NPSC meets Criterion 4, Aliant has performed analyses that support the adoption of a rate-of-return greater than the authorized interstate rate-of-return for this docket. Criterion 5 contains potentially conflicting goals for states such as Nebraska, which have authorized depreciation lives that are outside of Commission authorized ranges. The following is an explanation of the areas in which the cost study violates the FCC criteria and evidence to support the adoption of inputs other than those submitted by the NPSC.

A. Criterion 3: Study Must be Based on the Current Cost of Purchasing Facilities and Equipment

Part of Criterion 3 states, "[t]he study or model, however, must be based upon an examination of the current cost of purchasing facilities and equipment, such as switches and digital loop carriers (rather than list prices)."[5] The Notice also states, "in particular, describe and verify how the costs of facilities and equipment used in the study reflect the current costs of purchasing those facilities and equipment."[6] Aliant believes the NPSC did not meet this criterion for the categories that are discussed below.

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5 *See State Forward-Looking Cost Studies Order* at 6.

6 *Id.*

Aliant, as well as U S West,[7] GTE,[8] and Sprint,[9] supported the use of company-specific inputs in proceedings before the NPSC. Aliant understands the administrative burden of obtaining and maintaining a separate set of inputs for each non-rural company. However, if this is not done, inputs should be chosen to reflect the costs of all companies, including mid-size companies such as Aliant. In the 1998 Biennial Regulatory Review of Accounting and Cost Allocation Requirements,[10] the Commission recognized that the level of sophistication and economies of scale differ between the RBOCs and mid-size companies. These differences carry forth into the expenditures made by the companies.

In addition to differing costs, mid-size companies have different practices, such as using different brands and types of equipment than RBOCs. Inputs should be chosen to reflect the practices of all companies, including mid-size companies, as well as their costs.

Many of the inputs to the Benchmark Cost Proxy Model (BCPM) chosen by the NPSC are not representative of the state of Nebraska. Rather, the inputs are specific to two individual companies. These companies are U S West and GTE, companies with total access lines of

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7 *See* U S West Communications, Inc., *Direct Testimony of Peter B. Copeland*, Nebraska Application No. C-1633, Exhibit 32, May 11, 1998, p.2.

8 *See GTE Midwest Incorporated, Direct Testimony of David G. Tucek*, Nebraska Application No. C-1633, Exhibit 38, May 11, 1998, pp. 3-6.

9 *See* United Telephone Company of the West d/b/a/ Sprint, *Comments of United Telephone Company of the West*, Nebraska Application No. C-1633, May 8, 1998, pp. 5-7.

10 *See 1998 Biennial Regulatory Review—Review of Accounting and Cost Allocation Requirements*, CC Docket No. 98-81 and *United States Telephone Association Petition for Rulemaking*, ASD File No. 98-64, FCC 98-108, (rel. June 17, 1998).

16,132,694 and 17,860,527, respectively.[11] In comparison, Aliant has only 272,572 access lines.[12]

In addition to the fact that the NPSC has adopted inputs specific to large Tier 1 companies that are not reflective of the costs of mid-size companies, the NPSC mixed the inputs of the two largest companies, against the advice of those companies. Both companies testified that their inputs should be adopted as a set because they are interrelated.[13] The companies cautioned against a "pick and choose" methodology of adopting inputs, since the result could not be achievable by any company. Reasons for this include that contract prices are often negotiated as a package deal, or with specific volume requirements. In addition, there is often a relationship between investment and expense (i.e. increased investment can result in lower operating expenses). Picking the lowest "investment" of one company and the lowest "expense" of another would ignore this relationship creating an environment where none of the companies could achieve the expected result.

1. Loop Material Costs

The BCPM model does not include separate cost components for provisioning, exempt materials expense, direct labor, and engineering associated with the placement of copper cable. The model assumes that these costs will be included in the input value for copper cable. The copper cable costs submitted by GTE and adopted by the NPSC did not include all these

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11 *See* Federal Communications Commission, *Preliminary Statistics of Common Carriers*, 1997, (rel. May 1998), Table 2.10, Total Switched Access Lines less Mobile.

12 *Id.*

13 *See* GTE Midwest Incorporated, *Direct Testimony of David G. Tucek*, Nebraska Application No. C-1633, Exhibit 38, May 11, 1998, at 7 and *See Recommending a Cost Proxy Model to the Nebraska Public Service Commission for Purposes of Universal Service Support*, Docket No. C-1633, Volume V, at 663.

components (specifically exempt materials and engineering costs), and allowance was not made for these components in other inputs to the model.

GTE's copper cable cost inputs are generally lower than Aliant's cable costs, resulting in understated loop costs for Aliant. Aliant developed copper cable costs by using current prices for material, adding company documented provisioning and exempt material percentages. Aliant also added current direct installation labor and engineering percentages to the material cost. Several of the copper installed cable cost inputs that were submitted by the NPSC to the FCC are less than Aliant's current prices for material only.

At the Input Hearing held by the NPSC, GTE testified that their 26-gauge copper cable costs were company specific for GTE and not intended for use by other companies. Because GTE elected not to include exempt material and engineering costs in developing their 26-gauge cable costs, they reiterated in a subsequent Motion For Rehearing that their copper cable cost inputs were meant to be used only for GTE.

The 24-gauge copper cable costs adopted by the NPSC are not based on the current costs of purchasing facilities. U S West submitted 24-gauge copper cable costs for Nebraska, while GTE concurred with the BCPM default values. However, neither of these sets of inputs was adopted. The NPSC developed these costs by reducing US West's 24-gauge cable costs by percentages derived from the difference between U S West's 26-gauge cable costs and GTE's 26-gauge cable costs. These factored costs cannot reflect a true cost since GTE excluded exempt material and engineering costs in its estimated 26-gauge cable costs.

The NPSC adopted the 26-gauge copper cable costs submitted by GTE because, in their opinion, they were "more reflective of purchase prices in a competitive environment."[14] Aliant agrees with the statement that, "[o]ne purpose of competition is to force carriers to become more efficient."[15] However, contrary to the NPSC's conclusion that competition will lower cable prices, Aliant believes competition will likely raise cable prices because competition will reduce the customer base of the local exchange carrier, reducing the quantities of material purchased, which may, in reality, reduce the opportunity for discounts on cable prices.

2. DLC & Electronic Inputs

The input costs and relationships adopted by the NPSC for DLCs based on U S West data do not represent Aliant's costs for these facilities. The impact is significant and seriously understates the cost of a loop for Aliant. The NPSC selected costs associated with the DSC "Litespan-2000" DLC for inputs into BCPM for the larger-sized DLCs. Aliant uses the Nortel Access Node for large DLCs because of its multi-hosting capabilities and for the discount we receive as part of the Aliant-Nortel Switching Platform Agreement. The line card used in Aliant's larger-sized DLCs was selected because it is software programmable, capable of interchanging service types without changing out the line card. These line cards provide for, and do not impede, advanced telecommunications services, and are lowering operating and provisioning expenses. Also, Aliant may not be afforded the price discounts available to larger companies considering the smaller quantities Aliant would order.

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14 *See* Nebraska Public Service Commission, *Text Document*, at http://www.fcc.gov/e-file/cost_studies, p. 3.

15 *Id.*

B. Criterion 4: Rate of Return

The FCC has authorized the rate of return (cost of capital) for calculating federal Universal Service Fund ("USF") support to be 11.25 percent. This cost of capital was authorized by the FCC for interstate services prior to the adoption of the Telecommunications Act of 1996 ("1996 Act"). Aliant believes that the cost of capital should be forward-looking, as the basis for calculating federal universal service high cost support is forward-looking economic cost studies. Aliant also anticipates that competition brought about by the 1996 Act is likely to increase systematic risk and thereby raise the cost of capital. If no attempt is made to incorporate this risk in the cost of capital, unit costs of elements will most probably be underestimated. Therefore, the cost of capital to be used to calculate federal USF support should be the risk-adjusted forward-looking cost of capital.

Aliant has predicted the risk-adjusted forward-looking cost of capital. Since the telecommunications industry is still in the transition period toward deregulation, sufficient data are not available to quantify the effect of deregulation on its risk. Therefore, Aliant has used regional airline industry data to predict the level of risk the local telecommunications industry will face after deregulation. The principal reason Aliant decided to use airline data for forecasting the systematic risk for the telecommunications industry is that the airline industry was a regulated industry and went through a similar process of deregulation. In order to justify the use of airline industry data for forecasting risk for the telecommunication industry, Aliant has conducted a t-test to show that there was no statistically significant difference between levels of risk these two industries faced before deregulation. Applying time-series data to the ARMA (5,0) model the future annual market rate of return was predicted. The risk-adjusted forward-looking cost of capital of 12.61 percent was then forecasted using the Capital Asset Pricing

Model. Aliant believes that this cost of capital is the most appropriate for use in the operating environment that exists after the adoption of the 1996 Act.

C. <u>Criterion 5: Economic Lives Used in Calculating Depreciation Expense</u>

Depreciation lives for Aliant are set by the NPSC. Thus, these lives are the "currently authorized depreciation lives,"[16] one of the conditions for Criterion 5. The NPSC noted that it had previously prescribed economic lives that fall below the FCC's prescribed range for several categories.[17] In order for the NPSC to meet the other condition of Criterion 5, "[e]conomic lives. . . used in calculating depreciation expense should be within the FCC-authorized range,"[18] the NPSC elevated the prescribed economic lives to the bottom of the FCC range for the purpose of selecting inputs to a cost proxy model to determine universal service costs. In so doing, the NPSC was forced to violate the condition that they use "currently authorized depreciation lives." Thus, the Commission's Criterion 5 is internally inconsistent, in that in order to meet one condition (depreciation lives must be within Commission authorized ranges) another condition must be violated (use currently authorized depreciation lives).

The Commission recently sought comment on the particular values of depreciation lives that should be used to determine the forward-looking cost of providing supported services in a competitive environment.[19] In addition, the Commission has in more than one instance recognized that its depreciation rules need revision. For example, in the *Universal Service*

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16 *See State Forward-Looking Cost Studies Order* at 1.

17 *See* Nebraska Public Service Commission, *Text Document*, at http://www.fcc.gov/e-file/cost_studies, p. 3.

18 *See State Forward-Looking Cost Studies Order* at 7.

19 *See Common Carrier Bureau Requests Further Comment on Selected Issues Regarding the Forward-Looking Economic Cost Mechanism for Universal Service Support*, CC Docket Nos. 96-45, 97-160, DA 98-848, *Public Notice* (rel. May 4, 1998), at 5.

Order, the Commission said, "[w]e intend shortly to issue a notice of proposed rulemaking to further examine the Commission's depreciation rules."[20] In yet another order, the Commission stated, "[w]e reach no decision in this Order on the possible use of 'economic' depreciation methods in general . . . [t]he telecommunications industry is evolving, and this evolution may well require us to revise our prescription methods, or possibly discontinue depreciation rate prescriptions altogether."[21]

Given that the Commission is still seeking comment on what depreciation lives should be used to determine forward-looking cost, and given the Commission's own admission on more than one occasion that its rules need reexamination, it seems premature for the Commission to hold to its pronouncement that, "[e]conomic lives. . . used in calculating depreciation expense should be within the FCC-authorized range. . . ." Indeed, for Nebraska the Commission should adopt depreciation lives authorized by the NPSC which were not modified to fit the Commission's ranges. These lives are the "currently authorized depreciation lives" and are the most appropriate values to be used to determine the forward-looking costs of providing supported services for Nebraska.

II. Ameritech Michigan's Request For Waiver

Aliant supports the request of Ameritech Michigan for waiver of the Commission's authorized ranges of economic lives and future net salvage percentages used to calculate depreciation expenses. As noted in the previous discussion of the economic lives to be used for calculating depreciation expenses, the NPSC has also authorized depreciation lives outside of the

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20 *See Universal Service Order* at 250(5).

21 *See Price Cap Performance Review for Local Exchange Carriers*, 12 FCC Rcd 16642 (1997) at para. 65.

Commission's ranges for several categories of assets. Given the Commission's recent request for comments on the issue of depreciation lives, this is an appropriate time for the Commission to review the record and eliminate the constraint of using economic lives that are within ranges currently authorized by the Commission required by Criterion 5.

III. Conclusion

As discussed above, the selection of an appropriate platform and inputs to determine universal service costs is essential for mid-size companies and their customers. Failure to provide adequate universal funds for mid-size companies will result in higher local rates for mid-size consumers.

Respectfully submitted,

Robert A. Mazer
Albert Shuldiner
Vinson & Elkins, L.L.P.
1455 Pennsylvania Avenue, N.W.
Washington, D.C. 20004-1008
(202) 639-6755
Counsel for Aliant Communications Co.

June 25, 1998

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Comments of Aliant Communications Co. was sent by first-class mail, postage prepaid, this 25th day of June, 1998, to each of the following:

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Chairman William E. Kennard
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

Commissioner Harold Furchtgott-Roth
Federal Communications Commission
1919 M Street, N.W., Room 802
Washington, D.C. 20554

Commissioner Michael Powell
Federal Communications Commission
1919 M Street, N.W., Room 844
Washington, D.C. 20554

Commissioner Susan Ness
Federal Communications Commission
1919 M Street, N.W., Room 832
Washington, D.C. 20554

Commissioner Gloria Tristani
Federal Communications Commission
1919 M Street, N.W., Room 826
Washington, D.C. 20554

The Honorable Julia Johnson
State Chair, Chairman
Florida Public Service Commission
2540 Shumard Oak Blvd.
Gerald Gunter Building
Tallahassee, FL 32399-0850

The Honorable David Baker
Commissioner
Georgia Public Service Commission
244 Washington Street, S.W.
Atlanta, GA 30334-5701

The Honorable Sharon L. Nelson
Chairman, Washington Utilities and
Transportation Commission
1300 South Evergreen Park Dr. S.W.
P.O. Box 47250
Olympia, WA 98504-7250

The Honorable Laska Schoenfelder
Commissioner
South Dakota Public Utilities Commission
State Capitol, 500 East Capitol Street
Pierre, SD 57501-5070

Martha S. Hogerty
Missouri Office of Public Council
301 West High Street, Suite 250
P.O. Box 7800
Jefferson City, MO 65102

Charles Bolle
South Dakota Public Utilities Commission
State Capitol
500 East Capitol Street
Pierre, SD 57501-5070

Deonne Bruning
Nebraska Public Service Commission
300 The Atrium, 1200 N Street,
P.O. Box 94927
Lincoln, NE 68509-4927

Rowland Curry
Texas Public Utility Commission
1701 North Congress Avenue
P.O. Box 13326
Austin, TX 78701

Bridget Duff
State Staff Chair
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0866

Emily Hoffnar
Federal Communications Commission
Accounting Policy Division
Universal Service Branch
2100 M Street, N.W., Room 8617
Washington, D.C. 20554

Lori Kenyon
Alaska Public Utilities Commission
1016 West Sixth Avenue
Suite 400
Anchorage, AK 99501

Debra M. Kriete
Pennsylvania Public Utilities Commission
North Office Building, Room 110
Commonwealth and North Avenues
P.O. Box 3265
Harrisburg, PA 17105-3265

Sandra Makeeff
Iowa Utilities Board
Lucas State Office Building
Des Moines, IA 50319

Philip F. McClelland
Pennsylvania Office of
Consumer Advocate
1425 Strawberry Square
Harrisburg, PA 17120

Thor Nelson
Colorado Office of Consumer Counsel
1580 Logan Street
Suite 610
Denver, CO 80203

Barry Payne
Indiana Office of the Consumer Counsel
100 North Senate Avenue
Room N501
Indianapolis, IN 46204-2208

Timothy Peterson
Deputy Division Chief
Federal Communications Commission
Accounting and Audits Division
2100 M Street, N.W., Room 8613
Washington, D.C. 20554

James B. Ramsay
National Association of Regulatory Utility Commissioners
1100 Pennsylvania Ave., N.W.
P.O. Box 684
Washington, D.C. 20044-0684

Brian Roberts
California Public Utilities Commission
505 Van Ness Avenue
San Francisco, CA 94102

Kevin Schwenzfeier
NYS Dept of Public Service
3 Empire State Plaza
Albany, NY 12223

Tiane Sommer
Georgia Public Service Commission
244 Washington Street, S.W.
Atlanta, GA 30334-5701

Sheryl Todd
Federal Communications Commission
Accounting Policy Division
Universal Service Branch
2100 M Street, N.W., Room 8611
Washington, D.C. 20554

International Transcription Service
1231 20th Street, N.W.
Washington, D.C. 20036